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General Business Conditions

THE interest of the country at the New Year, and its anxieties as well, are intensely centered upon the battlefronts and upon the men and women of our armies. On New Year's Day in 1944 confidence was high that the Germans would be defeated within the year and that in this country a considerable degree of reconversion from war work could be completed. In the late Summer fulfillment of these hopes seemed to be approaching. Gradually, however, they have been dissipated. Now the tremendous drive of the German armies into Belgium, coming after the earlier indications that the Allied offensive was behind schedule, shows that they were founded on misinformation or misunderstanding. It is plain that the optimism of early Autumn underrated German strength, and that a revision of estimates of the military and economic situation in 1945 is called for.

Until recently the military situation had been compared with the Fall of 1918, with the Germans fighting stubbornly, but in retreat and nearing the end of their resources. Now comparisons are being made with the Spring of 1918, when the Germans for almost four months were able to follow one offensive with another, and then to fight off defeat for four months more. Whether the second comparison is nearer the mark, or whether the German offensive is a mere act of desperation, exposing them to earlier defeat, only the military authorities, if anyone, can say.

Certain facts, however, seem clear. One is that the Allied drive toward the Rhine has been disrupted and delayed by the need to contain the German drive. Another is that the battle is stupendous and costly, in men and supplies. A third is that German strength or desperation will not again be underrated—or the Japanese either—, and that planning now is on the basis that the war will require the maximum effort of this country for an indefinite time.

These are the facts that are overwhelmingly important in the domestic situation. They do not cast doubt on the final victory, but they point to a longer war than had been counted on. They point, in conjunction with reports during the American offensive in November, to a greater and more rapid consumption of munitions than had been assumed. They heighten the importance of shortages of critical items, such as artillery and ammunition, heavy trucks and tires, and the need to provide not only for heavier current consumption but for greater reserves. Finally, they remove ideas that the demands on the industries, in the aggregate, and on the American people as a whole will lighten at any predictable time.

Implications for Domestic Policy

In the field of public policy these facts signify that manpower and materials controls cannot be relaxed, or civilian production resumed and shortages relieved, to the extent earlier intended. They signify, subject to later developments, that government expenditures and deficits will not be reduced as much as previously believed possible, and that the ultimate debt will be larger. They indicate persistance of the inflationary danger on an expanded scale, because the inflationary forces will be greater and will be in operation longer.

The American people, whose sons are so bravely fighting, will not be dismayed at the turn of events, but renewed resolution and redefinition of personal responsibility in the war effort are called for. The need is for people to work more effectively whether they are in war plants or civilian occupations, to conserve their resources, to economize and save and buy more war bonds, and to take heed of the shortage of workers in plants making critical items. They should understand better that in indulging in extravagant buying, as they have done during the Christmas season to an extent never before equalled, they are spending money which ought to go to pay for the war, and are contributing to inflationary pressures. Each person's definition of his du-

ties and responsibilities, to his country and to the men who are bearing the terrible burdens of the battle, should be sober beyond all ordinary standards, after this revelation of the magnitude of the task ahead and the effort still required.

The 1945 Business Outlook

The emphasis on sustaining and increasing war production is the known element in the 1945 business outlook, and the uncertainty as to when the military situation will permit curtailment of war production is the unknown element. The pattern until Germany is defeated has been set; while war production is sustained employment, income and trade—to the extent that merchandise is available—will be sustained. The aim of the Washington agencies, above all else, is to increase production of critical items.

Outstanding among recent moves is the decision to start construction of new plants for mortar ammunition and heavy tires, although the plants cannot get into production for a good many months. This typifies current policy, which is to be prepared even at the risk of waste. The Maritime Commission has reviewed ship construction plans for 1945, which originally called for a decline as the year went on, and has added 186 cargo ships to the program. Airplane production schedules have been moderately increased. The textile requirements of the armed services have been raised considerably above earlier schedules.

To meet these needs and turn labor to production of critical items, the War Manpower Commission has tightened up its employment regulations and deferments from selective service of men above 26. The War Production Board has issued a variety of new regulations, particularly in the textile and apparel fields, to assure that requirements of the armed forces will have first priority. These controls apply to wool tops and cotton yarns, among others; they do not signify that civilian production will be stopped, as essential requirements will be given ratings, but they will reduce civilian supplies of worsted goods and such cotton products as drapery and upholstery fabrics, bedspreads, etc.

Lumber controls apparently will be tightened. Supplies of rationed shoes will decline. The copper situation is tighter because of the tremendous demand for brass for ammunition, and limitations on the use of lead are being tightened. The output of civilian motor trucks will be reduced drastically; also commercial vehicles in use will get not much more than half the tires they need in the first quarter of the year, and allocation of passenger tires has been ordered cut. The steel situation has tightened considerably, and will be further affected by the enlarged ship program.

Authorizations of new civilian production under the spot authorization procedure have virtually ceased, although still permissible in non-critical labor areas, and W.P.B. has formally expressed its intention to hold civilian production in the first quarter of the year at the present level.

For five months industrial production in the aggregate has been virtually unchanged, the Federal Reserve Board's index for November having been two points above last July. Evidently this figure, 232 on the basis 1935-39 = 100, represents an approximate ceiling, fixed chiefly by the present labor supply and by the difficulties incidental to shifts in manufacture from one product to another. Since more men are to be inducted into the armed forces, and highway transportation may give increasing difficulty, it seems unlikely that this ceiling can be raised; but the labor supply should be sufficient to maintain the present level of output if all concerned work with urgency and efficiency. November figures show that production of the critical war items was then making encouraging progress.

This projection of the economic situation leaves little room for additional moves toward industrial reconversion. The official policy is to frown even upon discussion, for fear it may influence workers to leave war plants for civilian jobs. This policy obviously does not suppress all progress toward meeting reconversion problems, such as perfection of the con tract termination and surplus disposal machinery of the Government and private planning by corporations where it does not interfere with the war effort. Business long has been on notice that the situation will change when the German war ends and naturally does all it can to prepare for the change. However, reconversion is put in the background, and appropriately so, in order to concentrate all energies on the urgent needs.

Combatting Inflation

Apart from the need to increase war production, the most urgent domestic problem of 1945 is to combat the inflationary danger through rigid economy, both governmental and private, through saving and investment in war bonds, and through cooperation in the stabilization measures. Commodity prices have been well stabilized during 1944, on the average, but the uptrend though slight has been persistent and the price indexes at the year-end are the highest yet reached. The actual price rise is less disquieting than other aspects of the situation. One is the heavy spending so recently in evidence. Another is the indication that supplies of some consumers' goods will be reduced rather than increased in 1945.

Most disquieting of all is the resistance of special groups to stabilization measures ap-

plying to them. The Little Steel wage formula is being adhered to in name, but broken in practice. Increased wage rates so far have been absorbed largely by increases in volume and narrowing of profit margins, but with volume at the ceiling one way to absorb higher wages is already closed. If the decision of the War Labor Board to raise steel wages is followed as widely in other industries as seems likely, the upward pressure on prices of manufactured goods during 1945 will be greater than since the early stages of the war.

The necessary precedent to adoption of sound policies, both in the public and private sphere, is sound analysis of the problem. People need to be reminded again that, despite the gratifying degree of price stabilization during the war, the inflationary forces are greater than ever known. If the war is protracted they will be raised to still greater heights and their pressure multiplied.

Sixth War Loan Results

Preliminary figures for the Sixth War Loan Drive indicate that total sales passed $21 billion and exceeded those of any previous drive. The overall quota of $14 billion was passed by the middle of the drive, and it now appears that both the $5 billion quota for total sales to individuals, and the $2.5 billion quota for series E bonds, upon which the major share of the sales efforts was concentrated, were also reached by the end of December.

Prices on all of the open-market issues have advanced to premiums over the offering price of par, with the 2½ per cent bonds of 1966-71 quoted at the end of December at 100 11/32, the 2 per cent bonds of 1952-54 at 100 10/32, the 1¼ per cent notes of 1947 at 100 7/32, and the ⅞ per cent certificates at a yield basis of 0.82 per cent. Total public debt was carried by the new financing to about $232 billion, which compares with $170 billion one year ago, $61 billion at the time of Pearl Harbor, and the interwar low of $16 billion at the end of 1930.

The large oversubscription recorded in the drive is all the more noteworthy in view of the fact that this marked the sixth of a series of war loans, coming along at intervals of five months or less, that have raised an aggregate of nearly $100 billion in a period of approximately two years. It was the third loan in the calendar year 1944.

The large numbers of subscriptions and the huge dollar totals recorded in the drive reflect the hard work and devoted services of thousands of volunteer salesmen and workers of all kinds, and the support of industry and trade groups, insurance companies, labor organizations, artists and entertainers, schools, and many others.

The banks throughout the country have surpassed all previous records in their direct sales to customers, as well as in their assistance to selling teams organized by industries and by communities. Following the American Bankers Association convention in Chicago last Fall, where plans were presented for more systematic organization of the country's banking system in the support of the loan drives, the various state bankers associations have held many group meetings for the purpose of getting the largest possible coverage of individuals and businesses in their localities.

In a rapidly growing number of states the banks have adopted a uniform system of reporting their bond sales as a percentage of their deposits, and such a comparison has been found to be stimulating to sales efforts.

Proportion of Bank Credit Involved

The real test of the success of the drives, however, is not merely in the total amount of money raised but in how many individuals subscribed and in how much inflationary money was absorbed. For such an analysis the figures need to be broken down to determine what proportion of the securities sold was financed by an expansion of bank credit, with its inflationary effect of adding to the sumtotal of purchasing power available.

A summary is given on the following page of the estimated increase in commercial bank holdings of government securities and in loans against securities, also Federal Reserve Bank holdings of government securities, compared with the net increase in public debt during the six war loan drives.

It will be seen from the table that during the Sixth War Loan, from November 1 to the end of December, there was a net increase of about $6.9 billion in the estimated total government security holdings of all commercial banks, based on the changes of the weekly reporting member banks. This increase took place notwithstanding the fact that the banks were not permitted to subscribe directly during the drive (except for limited investment of their time deposits) and represented largely the purchase by the banks of old issues of government securities liquidated by other investors desiring to subscribe to new issues.

There was at the same time a rise of $1.8 billion in the estimated total of loans on securities, practically all of the increase occurring in the loans made against government securities for the purpose of assisting brokers, dealers and others in their purchase of new issues. The estimated increase of $8.7 billion in these investments and loans combined was about 43 per cent of the estimated net increase of $20.3 billion in public debt during the same period—a lower ratio than in the fifth drive but substantially above the third and fourth.

Net Increase in Outstanding National Debt, Commercial Bank Holdings of Government Securities and Loans on Securities, and Federal Reserve Bank Holdings of Government Securities, During Six War Loan Drives
(In Millions of Dollars)

Change in	First War Loan Dec. 1942	Second War Loan Apr.-May '43	Third War Loan Sep.-Oct. '43	Fourth War Loan Jan.-Feb. '44	Fifth War Loan June-July '44	Sixth War Loan Nov.-Dec. '44
Gross National Debt	+11,889	+20,120	+21,046	+17,204	+22,207	+20,300*
All Commercial Banks						
Government securities	+ 4,640	+ 8,680	+ 6,700	+ 5,060	+ 8,800	+ 6,940
Loans on securities	+ 500	+ 650	+ 1,510	+ 1,090	+ 1,700	+ 1,750
Total	+ 5,140	+ 9,330	+ 8,210	+ 6,150	+10,500	+ 8,690
% to Debt increase	43%	46%	39%	36%	47%	43%
Federal Reserve Banks						
Government securities	+ 1,146	+ 262	+ 104	+ 9	+ 551	+ 1,459
Total—Commercial banks plus Federal Reserve	+ 6,286	+ 9,592	+ 8,314	+ 6,159	+11,051	+10,149
% to Debt increase	53%	48%	40%	36%	50%	50%

* The net increase in public debt differs from reported War Loan sales because of a number of factors, including deferred payment sales, redemption of savings bonds, tax notes and other securities, the issuance of special securities to government trust funds, and exclusion from drive quotas of Treasury bills, sales to government agencies, and limited sales of long-term bonds to commercial banks for investment of time deposits.

Including the Federal Reserve purchases of government securities, the total bank credit involved in purchase of or loans on government securities was over $10 billion or approximately half of the estimated debt increase during the last drive. This compares with previous drives as shown in the table.

While some readjustment of investor portfolios is legitimate and not to be criticized, a large turnover induced by competitive bidding for outstanding government issues by banks in order to obtain sales credits or war loan deposits resulting from switching customers into the new issues has the effect of padding the figures and lending a false air of success to the drive. Such consequences are harmful in that they discourage maximum efforts to reach prospects who should be investing and whose purchases would absorb purchasing power that might otherwise be spent.

Annual Comparisons More Favorable

In examining the table it should not of course be assumed that the figures can be cumulated to show the total expansion of credit relative to the increase in debt during the entire period, since the figures do not reveal what took place in the months between the drives. The commercial banks take on substantial amounts of securities during bond drives when their reserve requirements are reduced by the shift of private deposits to war loan deposits requiring no reserve.

Following the drives, as government deposits are withdrawn by the Treasury and reconverted through disbursements into ordinary deposits requiring reserves, the banks become sellers of governments, a large part of which is taken up by the Reserve Banks. This gives to the curve of bank credit expansion a generally zig-zag appearance, but with the trend moving steadily upward.

In the case of loans against securities, there has been a substantial liquidation in the months following the drives, although here also the long-term trend has been upward.

When comparison is made of bank direct purchases of government securities to the debt increase on an annual basis, it will be found that the proportion taken by the banking system has steadily declined, as indicated by the following table:

Increase in Total Government Debt and Portion Taken by the Banks During Calendar Years 1942-44
(In Millions of Dollars)

	1942	1943	Est. 1944
Interest-bearing Debt, Direct and Guaranteed			
Net Increase	$47,823	$57,141	$62,000
Taken by Banks			
Commercial Banks	19,585	18,472	15,155
Federal Reserve Banks	3,935	5,354	7,521
Total	23,520	23,826	22,676
% Taken by Banks	49%	42%	37%

In dollar totals the amount of net debt increase absorbed by the commercial banks has declined steadily from 1942 to 1944, whereas the amount absorbed by the Reserve Banks has risen rapidly. The combined absorption by the commercial banks and Reserve Banks has been held in the neighborhood of $23 billion, despite the rising volume of debt to be financed. The ratio of bank credit to debt increase has declined accordingly.

At the end of 1944 the estimated government debt held by the commercial banks was around $75 billion, while that held by the Reserve Banks was $19 billion.

Need for More Effective Focus on Individual Subscriptions

While the declining annual percentage of debt taken by the banks is encouraging, the proportion of bank credit involved in a war financing program that is aimed at raising funds outside of the banking system is still much too large. The results demonstrate how much is still to be done in getting the right kind of subscriptions before we can sit back and congratulate ourselves on the enormous totals being rolled up in the drives. It is easy enough to float large quantities of securities that can be paid for directly or indirectly by expansion of bank credit. The real job is in selling securities to individuals and other investors who will pay for them out of money that is saved.

The last drive hardly made a dent in the volume of money in circulation, now swollen to over $25 billion. Retail trade last month was still at peak levels, and there was continued evidence of free and extravagant spending for luxury goods, amusements and travel.

The question needs consideration whether in future financing the focusing of attention upon individual subscriptions could not be made more effective by separating the drives into one for individuals, and another, at a different date, for corporation and other investors. Large subscriptions from these latter sources tend to discourage small individual purchases, and the abnormal switching during drives by large holders inflates the sales totals still more.

In any event there is room for improvement in the methods of handling the large subscriptions, and apportioning sales and war loan deposit credits. The exclusion of commercial banks from subscription to new securities during the drives tends to encourage competitive bank bidding for old securities and for war loan deposit credits arising from the shifting of customers into new issues. This condition might be remedied, and the government bond market made more healthy and less speculative, by providing for a direct offering of new securities to the commercial banks following the close of each drive.

In the long run, the effectiveness of the war loan drives will depend on individual solicitation and on a broad educational program, getting people to spend less and to save more, emphasizing the importance of systematic saving and of bond purchases for permanent investment through regular payroll deductions. This calls for each and every individual and organization doing everything possible to help reach these objectives, not just during the bond drives, but constantly throughout the year.

An Employment Budget?

The December issue of this Letter contained a discussion of the argument, currently heard in many quarters, that unless business (or the private enterprise system) provides "full employment" the Government must. A legislative proposal made public December 17th by the War Contract Sub-committee of the Senate Military Affairs Committee, "for the purpose of stimulating discussion," embodies a program for making full employment a government policy, and invites this postscript to our December article. The substance of the proposal is that the President, along with the regular budget estimates transmitted to Congress each January, should also transmit detailed estimates of the following:

(1) The number of jobs needed during the ensuing fiscal year to provide full employment; also the dollar volume of the national product, at the expected level of prices, needed to provide the stated number of jobs;

(2) The volume of investment and other expenditure by private enterprise and governmental bodies required to assure the stated national product;

(3) The volume of investment and expenditure by private enterprise and governmental bodies that is actually expected.

The proposal further provides that if the estimated prospective expenditure is less than the volume required to assure full employment the President shall set forth a program, first, for encouraging non-federal expenditure, and, second, for making whatever volume of federal expenditure shall be necessary to fill the gap.

The proposal includes two declarations of policy — (1) that every American able and willing to work has the right to a useful and remunerative job, (2) that it is the responsibility of the Government to guarantee that right by assuring continuing full employment.

If this proposal receives serious attention and debate in Congress it is likely to become the focal point upon which discussion of the full employment problem will finally center. Doubtless it will appeal to many people, since it raises in the mind a graphic picture of an economic system kept continuously in order, and providing jobs and prosperity for all, by the seemingly simple device of having an overhead authority furnish jobs to everyone who does not find private employment. Its seeming simplicity and attractiveness, however, should make examination of the proposal all the more careful. Most of the economic illusions of the past have been propagated by graphic word pictures, sweeping sympathetic readers along.

Fallacies of the Proposal

The fallacies of the proposal begin with the declarations on which it is based. To state by law that every American has a "right" to a useful and remunerative job does not make it so, any more than a statement that every American has a right to $10,000, or to an annual trip to Washington, would make it so. The Government can confer benefits upon people only if benefits are practicable. The question is whether it is practicable for the Government to provide jobs, and if so at what cost.

The declaration that it is the responsibility of the Government to guarantee the right to a job by assuring continuing full employment goes far beyond any statement of governmental functions that Americans have ever accepted in the past. There may be honest differences of opinion as to what they will accept in the future; however, the declaration as worded goes farther even than many advocates of "compensatory federal expenditure" or "compensatory fiscal policy" think is practicable. Many people, including conservatives, believe that the country will never again tolerate mass unemployment and will adopt federal work programs on any scale necessary to prevent it. But by "mass unemployment" they usually mean millions out of work, as during the great depression. The sub-committee's proposal, however, is not limited to averting mass unemployment, but would provide "full employment", which is another conception.

Under the proposal full employment would be numerically defined by the President, of course with the aid and counsel of the statistical agencies of the Government. The pitfalls in attempting to measure full employment numerically were set forth in the article in our last issue. Those difficulties, however, would be less than the difficulties of the President's second task, namely, to predict prices and estimate the volume of national product required to assure full employment; and they would be utterly insignificant in comparison with the difficulties of the third task, which is to estimate the volume of expenditure actually to be expected during the fiscal year.

Nothing in the record of statistical projection and prophecy justifies a belief that such estimates could provide a guide reliable enough to warrant the Government undertaking — on their showing — policies having such potentialities for evil as well as good. If there is any subject upon which the Government should be a supremely competent authority, it is in the estimation of its own expenditures. Yet in four out of five of the last peacetime budgets (ending in 1939) the January estimates of expenditures one year ahead missed the actual results by 14 to 32 per cent. If it can do no better in its own field, how much worse might it not do in the infinitely more complex task of estimating private expenditures, and how much graver would be the consequences of its errors.

The proposal assumes throughout a degree of omniscience and foresight on the part of the Government which cannot possibly exist. The same erroneous assumption underlies the broader proposals, advanced by some, for general overhead planning and control of economic activity.

The "Make Work" Idea

The most fundamental fallacy of the proposal was touched on in our article last month. It lies in the fact that if the provision of employment is made the primary function of economic activity, and the Government is required to supply jobs, the cost and usefulness of the work done will be the subordinate consideration. Under such a policy it must be expected that "made work" would be carried on, the term signifying work which neither serves an economic purpose nor is self-supporting. The costs would fall on all business and all the people, either through taxes or inflation of the government debt. Or the Government might engage in activities intended to be self-supporting, but competing with private enterprise. In either case private investment and expenditure would be discouraged and the gap to be filled by government expenditure would be widened. There would be set in operation a vicious circle whose logical end would be steadily increasing totalitarian controls and destruction of private enterprise.

It is urged that what the Government does in war it can do in peace. But the costs of the war have not yet been paid, and there is no valid evidence that Government can do in peace what it can do in war except with the same enormous waste, gigantic cost and inflationary danger associated with war. It is sometimes said also that if Germany could provide full employment before the war the United States can do so. But the German economy before the war was essentially a war economy, devoted to armament production. The inflationary consequences were repressed by regimentation and strict controls, including depression of wage rates and suppression of labor unions, — in short, the Nazi system against which we are fighting.

The responsibility for employment is a responsibility of everyone, — of labor not to price itself out of jobs and to give full work for full pay, of employers to conduct their business with vision and enterprise, seeking to serve the people by making more and better goods at lower costs, and of the Government —not to "make work" — but to provide the en-

vironment under which investment can go forward and enterprise function.

Hearings on the Cotton Problem

The Sub-committee on Post-War Policy of the House Agricultural Committee deserves credit for a constructive action early last month, when it invited representatives of the various branches of the cotton industry to appear before it and make suggestions for solution of the cotton problem. The problem was discussed in this Letter two months ago, in connection with the export subsidy and government purchases; and the extended analysis made at the Washington conference need not be repeated here. The principal cause of concern now, from the long view, is the artificial domestic price, supported by government loans and purchases. The Government is committed to this policy by law. But the cotton merchants who must sell American cotton abroad in competition with foreign cotton, and the textile manufacturers who must sell cotton fabrics in the domestic market in competition with synthetic fiber and paper products, all emphasize that if cotton is to stop losing outlets at home and abroad, it must be sold in the market at a competitive price.

Testimony was presented to show how real is the competition of rayon and paper products with cotton. One expert pointed out that rayon staple fiber now enjoys a 3c price advantage—allowing for the smaller waste in spinning—over the basic grades of cotton. The growth of rayon over the past twenty years or more has been at the expense of cotton as well as silk, and few doubt that competition from rayon in the future, when the increased plant capacity built up during the war becomes available for peacetime uses, will be greater than in the past. The history of synthetic products is one of steady improvement of quality, accompanied by steady lowering of prices. Recently, for example, the price premium previously permitted on heavy duty synthetic rubber tires made of rayon cords, over the usual cotton construction, was removed by O.P.A., due to the fact that manufacturing experience had reduced costs to the point where rayon tires could be sold as cheaply as cotton tires. Only cheaper cotton can succesfully combat such trends.

Secretary Wickard's Proposal

Cotton growers at the hearings were less impressed by these representations than by their feeling that they should have parity prices and parity income, and were inclined to favor continuing the high loan rates and meeting foreign competition by the export subsidy. But Secretary of Agriculture Wickard declared that support of the market at high prices and export subsidies alike could be only temporary expedients, which offer no solution for the basic problem.

Secretary Wickard argued for a new policy which would again place American cotton on a competitive price basis both at home and abroad. He proposed that the income which the farmer received from selling cotton at competitive prices be supplemented with payments from the Treasury, but only for a fixed time and on a gradually diminishing basis. During this period farmers would be expected to reconvert their operations, some turning to the complete mechanization of the growing and harvesting of cotton on the flat lands suited to such operation, while in other areas cotton growers would shift to other crops and livestock. Farmers receiving income payments under this proposal would be required to make adjustments which would eventually concentrate cotton growing in areas where the greatest reduction in production costs could be obtained. Admittedly a stop gap measure, the income payments would be expected to cushion the cost of the adjustments. To quote Secretary Wickard:

> For a short time, such an approach would require heavy government spending to protect farm income and to aid farmers in adjusting operations. But it offers a real possibility for eventually doing away with large annual subsidies, and the best possibility for a permanent self-sustaining farm population in the South, where many of the people and so much of the land are so well fitted for cotton production.

Because it provides for gradual reduction and definite termination of government payments, Secretary Wickard's proposal is plainly an improvement as compared with the commitments which the Government now has to the cotton growers. It is incontestably sounder to limit subsidies to people who are taking steps to reduce production costs than it is to pay them almost indiscriminately. Nevertheless, questions arise. Could the Government plan and enforce adjustments which would permit one man to grow cotton, but forbid another from doing so? Would the "cushion" delay the adjustments? Would political pressures interfere with the scheduled curtailment of the subsidy? The history of the past fifteen years, during which the cotton acreage has been cut more than half but price-supporting measures have been steadily expanded as described in our November Letter, is far from reassuring.

Reducing Costs of Production

The most forward-looking statements made at the conference were those which emphasized that the soundest solution of the cotton problem is a lower cost of growing cotton. Mr. Oscar Johnston, a cotton grower whose opinion is much respected, pointed out that

as costs are lowered loan rates and prices can be lowered while maintaining the farmer's net income.

Cost reduction, through improved methods, has been the source of all the economic progress in history. The great hope of reducing the cost of cotton production lies in the mechanization of cotton culture. For many years the vision of mechanical cotton pickers, especially, has attracted pioneers and inventors, and their work is now bearing fruit to an extent which the general public has not yet realized. During the past season, cotton has been produced successfully on the 2,000 acre Hopson Plantation, at Clarksdale, Mississippi, in the flat Delta region, on a completely mechanized basis, employing no hand labor, and using improved mechanical pickers. Not only was the soil preparation and planting performed mechanically, but insecticides and chemicals for defoliation were applied from airplanes, and cultivation done by flame throwers.*

The development of chemical defoliation, a process which destroys most of the leaves on the cotton plant just prior to harvest, is almost as important a contribution to mechanical picking as the perfection of the harvester itself; for a major obstacle to successful picking by machine has been the tendency of the barbed revolving spindles to pick the leaves as well as the cotton. The flame cultivator is an ingenious device which throws an oil flame under compression along the rows and kills grass and weeds without injury to the cotton plant. On this plantation the chopping operation, which next to harvesting is the greatest consumer of man-hours in cotton growing, is entirely eliminated.

Costs of Mechanical Picking

The mechanical cotton harvester picks in a day as much cotton as 60 hand operators usually pick. On the Hopson Plantation, where accurate records have been kept, the cost for machine picking a bale of cotton in 1943 was $5.26, compared with a cost of $39.41 per bale for hand picking on the same plantation. After deducting for the lower grade of the machine-picked cotton, the saving was $24.82 per bale as against the hand picked cotton. Thus, on the harvesting operation alone mechanization has reduced cotton growing costs by 5c lb., which is nearly 25 per cent of its present selling price. Level land is a pre-requisite.

The Hopson Plantation is a large unit, and its methods can hardly be applied on small farms. But looking into the postwar era, when improved types of farm equipment undoubtedly will be available, steady mechanization of cotton growing in suitable areas seems as inevitable as was the mechanization of wheat production on the Great Plains after World War I. Writing in the October issue of The Staple Cotton Review, official publication of the Staple Cotton Cooperative Association, Manager W. M. Garrard reaches the following conclusion in a stimulating analysis of the cotton problem:

> It is our judgment that cotton can be produced mechanically in a great area of the South, an area that will produce ten or more million bales each year, and the production and harvesting can be secured on a cost basis of 6c to 7c a pound, including all costs of every nature connected with the large plantation operation.
>
> This, as I see it, is the answer to the cotton problem. It is the best answer to be had for cotton as a competitor with synthetic fibres, and it is also the best answer to competition from foreign growths. No country has ever been able to compete with America on assembly-line industrial production. Neither do I believe any foreign country can compete with us on assembly-line agricultural production.

If Mr. Garrard's view is correct, there will be in time a large number of cotton producers with costs low enough to meet all competition. For those whose lands are unsuited to changing methods of cotton culture, cotton growing evidently will become less and less attractive. To support high-cost producers by maintaining artificially high prices only perpetuates the problem.

On the other hand, abandonment of single-crop cotton farming and the introduction of livestock and crop rotation, with proper planting of cover crops and grasses and modern soil conservation measures, can vastly increase the productivity of eroded hilly lands and raise living standards by provision of a more abundant and diversified diet. It is encouraging that while mechanized cotton farming is making progress in some areas, diversification and soil improvement are progressing in areas not suited to mechanization. Mr. Cason J. Callaway, Blue Springs Farms, Hamilton, Georgia, one of the distinguished and public-spirited men of that State, has recently made proposals for a broad program of land improvement, based on his own experience in building up average upland Georgia land into profitable farms. He stresses soil improvement, conservation, diversification, permanent as against annual crops, and facilities for food preservation. Solution of the cotton problem will come, not overnight but through patient work and progress, from this direction as well as from mechanization.

Currency Reconstruction in Europe

The enormous difficulties of currency rehabilitation in liberated Europe have been illustrated by the news from Belgium, France and Greece during the past few months. Four

* This story is told in detail in the November issue of the "Acco Press", published by Anderson, Clayton & Co., Houston, Texas.

years of German occupation and exploitation left a heritage of monetary chaos, and reconstruction must be undertaken while the fighting continues, while production, distribution and communication are disrupted, and while political and social strife are widespread. In all three countries government deficits, swollen to huge figures by the costs of German occupation and of goods and services commandeered by the Germans, have had to be financed by borrowing from central and commercial banks. Currency and bank deposits have been inflated enormously, while supplies of goods have been depleted.

Price controls and rationing exerted some restraint on the inflationary influences, but in Greece nothing could avert almost complete destruction of the currency, and controls were only partially effective in other countries. One of the ironies of the situation is that the process of liberation, resulting in changes of government and fresh economic disruption, weakened the effect of the controls. Black market operations have spread and shortages have been aggravated by hoarding and transportation breakdowns.

Wartime Expansion of Note Circulation, Bank Credit and Public Debt
(In Billions of National Currency)

	Aug. 1939	Sept. 1944	% Chg.
France (francs)			
Bank deposits	70	250	+257
Notes in circulation	142	600	+322
Public debt	445	1,650	+271
Belgium (francs)			
Bank deposits	29	83	+186
Notes in circulation	26	100	+285
Public debt	39	130(a)	+233
Greece (drachmas)			
Bank deposits	24	n.a.	
Notes in circulation	10	(b)	

(a) June. (b) 2,500,000,000 billions or 2½ quintillions; the initial issue of new drachmas amounted to only about 140 millions. n.a.—not available. Source: League of Nations Monthly Bulletin of Statistics, London Economist, and recent press reports.

The Fundamental Problem

The fundamental problem faced by all liberated countries is to restore production and distribution of goods and to apply counter-inflationary measures in the field of currency and credit. This calls, first of all, for a spirit of national unity and devotion to the task of reconstruction. People have to stop fighting among themselves and go to work, planting and harvesting their crops, and doing what they can to repair their homes, their industries, and their transportation systems. Second, it calls for re-establishing and strengthening rationing and price control. It calls for improvement in shipping, so that imports may be increased. Supporting these efforts must be moves toward reestablishing a sound fiscal and credit policy, economizing in government expenditures, restoring tax collections as rapidly as possible, restraining bank credit and note circulation, funding debt and stimulating savings. Only by bringing about a better balance between the volume of goods and outstanding circulation can prices and wages be stabilized and inflationary trends arrested.

One of the first tasks was the fixing of exchange rates, to have a basis for transactions with the liberating armies and for trade, wherever possible, with the outside world. With the collaboration of the United Nations, the policy has been to set the official exchange rate of the liberated countries as near the prewar level as possible. The official rates are admittedly far out of line with the internal purchasing power of the currencies. There is a natural reluctance to fix exchange rates on the basis of extreme prices prevailing at a time of great scarcity of consumers' goods. Also, high rates enhance the power of the liberated currencies to buy abroad. Another effect is to limit purchasing power in the hands of soldiers, and thereby prevent competition with the civilian population for the available consumers' goods, although this results in exorbitant prices for everything purchased by the British and American governments and soldiers within the liberated countries.

Foreign Exchange Value of Certain Continental Currencies

	In cents per unit			1939 = 100		
	Summer 1939*	Spring 1940†	Fall 1944	Summer 1939*	Spring 1940†	Fall 1944
France—franc	2.65	2.06	2.00	100	78	75
Belgium—franc	3.40	3.38	2.26‡	100	99	66
Netherlands—guilder	53.28	53.09	37.75‡	100	99	71
Greece—drachma	.857	.678	.673**	100	79	79
Italy—lira	5.26	5.04	1.00‡	100	96	19
Germany—reichsmark	40.11	n.q.	10.00‡	100	—	25

* Average June-July 1939; † average March-April 1940; ‡ rates made available for Allied forces; ** new drachma; n.q. no quotation.

Sweeping Reforms in Belgium

In Belgium note circulation and bank deposits together increased during the German occupation from about 65 billion Belgian francs in May 1940 to 183 billion in September 1944, or by about three times. Last Fall there was only a few months' food supply left, farmers were refusing to sell their products for paper money, and activity in the coal, steel and other important industries was at subdepression levels. Since industrial and harbor facilities had been only lightly damaged, however, the chances of restoring production and resuming imports of raw materials and foodstuffs seemed promising.

On this situation Mr. Camille Gutt, the returning Minister of Finance, laid his plans. First, the exchange rate of the Belgian franc was officially set at 176⅝ francs to the pound sterling and 43.77 to the dollar, compared with the prewar rate of 29 francs to the dollar. Next, the external stability of the franc was

fortified by a three-year agreement with Great Britain providing for mutual credits, equivalent to $20 million, for financing payments between the two countries. Other Belgian resources included the National Bank of Belgium's gold assets, carried at the equivalent of $734 million, and official and private Belgian gold and bank balances in the United States amounting to around $440 million when impounded at the time of the German invasion (but probably including some gold counted also in Central bank holdings).

The next monetary move, early in October, was to attempt the drastic reduction, within one week's time, of the outstanding note and bank credit to the level existing in May 1940. All bank notes of 100 francs or larger had to be surrendered into blocked accounts (except that 2000 francs per person were replaced by new notes). Lower denomination notes remained in circulation. All bank balances were blocked except for 10 per cent of the total or the credit balance shown in May 1940, whichever was greater. Business establishments had their bank balances freed to the extent of 1,000 francs for each employee.

The Minister of Finance was to decide, after one month, how much of the surplus notes and bank deposits was to be released immediately. Thereafter, 40 per cent of the bank balances was to be blocked temporarily, and released progressively when the Belgian economy could absorb the funds; the remaining 60 per cent was to stay blocked and to be used eventually in payment of war profit taxes. These taxes are expected to yield about 50 billion francs.

These monetary decrees proved highly unpopular. Farmers for a while refused to sell. Black markets expanded. At one time it seemed that the Pierlot government might fall on the issue. Nevertheless, by the end of October the Minister of Finance was able to report a reduction of bank deposits and note circulation to 56 billion francs (including some 4 billion of small denomination notes which were not subject to surrender), which was actually below the May 1940 level. By the middle of November the Government authorized release of a further 3,000 francs per person from the impounded balances. This gradual expansion of the means of payment was accompanied by an increase in imports of foodstuffs and other consumer goods.

Monetary Measures in France

In France, which had to pay an occupation levy of some 860 billion French francs, the inflationary pressure has been even more explosive than in Belgium. Total note circulation and bank deposits increased about four times, from some 210 billion francs in August 1939 to around 850 billion in September 1944. The public debt rose in the same period from 445 billion francs to 1,650 billion, two-thirds of which was either in the form of short-term Treasury bills or advances from the Bank of France. Black market activities were evidently even more widespread than in Belgium, partly because the Vichy control measures were less effective and partly because of a greater disorganization of the French economy during the liberation.

The exchange of the French "liberation" franc, as of the Belgian franc, was set high: at 200 francs to the pound sterling or 50 francs to the dollar, against the rate of 38 francs in the Summer of 1939. Gold had to be surrendered and foreign exchange and securities deposited, subject to license. The gold assets shown in the July statement of the Bank of France were equivalent to about $2 billion, which has since been reduced by payment of the Belgian claim of $223 million, and perhaps also in other ways.

The measures taken to eliminate excess purchasing power by curtailing bank credit and note circulation were conservative as compared with the drastic Belgian decrees, but a decline in outstanding note circulation below the 600 billion level was recently reported. Early in November subscriptions were opened for a 3 per cent "perpetual" Liberation loan which could be paid for in bank notes, medium and short-term Treasury bills or four-year savings certificates. No limit was fixed. According to the best information received here, about 160 billion francs was subscribed in six weeks, which exceeds expectations; and almost half of the subscriptions was in cash.

Complexity of the Problem

The Provisional Government has had many reasons for moving carefully. Until quite recently Paris evidently was not fully informed on conditions in various other parts of the nation, communications having been defective and unreliable. There was also some justification for belief that the internal purchasing power of the franc would improve, i.e., prices would decline, once a better distribution of goods, reported fairly plentiful in some regions, was obtained. Moreover, political factors had to be considered. Blocking of all but a small proportion of bank note holdings and bank deposits of farmers would be highly unpopular.

Further reduction of the funds feeding the black markets is desirable, and additional taxation and possibly other measures may be necessary, but arguments against too sharp or sudden deflationary measures are forceful. The Government seeks the way out through resumption of consumers' goods production and improvement of distribution, and would

place large orders for equipment and materials abroad. But rehabilitation will be slow, especially as the armed forces have the first claim on harbor and transportation facilities. Judged by black market quotations, which range from 200 francs to two or three times that figure for the dollar, the franc buys goods or services equivalent to one-half of one U. S. cent, or less. Abroad it buys the equivalent of 2 U. S. cents.

To bridge the difference in purchasing power by increasing the volume of goods alone, without reducing bank credit and currency, is likely to prove a difficult task, especially as more purchasing power will be created through budgetary deficit financing. Moreover, wages and costs are beginning to adjust themselves to the price level based on the black markets. The continuation of such a trend would necessitate an eventual lowering of the present exchange value of the franc.

Greece Issues New Currency

In Greece last Summer, as in Germany back in 1923, inflation had progressed too far to be brought under control. Banknotes became valueless and business was reduced to barter. The Allied authorities found it impossible to fix any rate of exchange for the old drachma, and there was nothing to do but wipe the slate clean and issue a new currency. The new drachma, backed by overseas holdings of gold and foreign exchange estimated at about £43 million, was put into the hands of the public early in November, one new drachma replacing 50 billion of the old. The exchange value of the new drachma was fixed at 600 to the pound, or 150 to the dollar, as compared with 117 drachmas to the dollar before the war.

Inflation in Greece got its start when the war interfered with importation of goods. Income from shipping revenues, tourist expenditures and immigrant remittances, which normally helped to pay for imports, was sharply reduced and soon shut off completely. Shortages of basic foodstuffs developed and, following the German and Italian looting, destruction of productive equipment and a series of poor harvests, the country went down to near-famine rations. An added complication was the loss of tobacco-growing districts to Bulgaria, which almost eliminated Greek exports and deprived the Greek Government of the bulk of its revenues. To balance budgets and to defray occupation costs, the Government had to borrow at an ever-increasing rate from the Bank of Greece.

Efforts to break the vicious spiral of inflation, ranging from the blocking of bank deposits to the sale of gold, proved of no avail. The gold sovereign which sold for about 1,000 drachmas before the war, advanced to 3 billion drachmas in August 1944, 30 billion by the middle of September, and 20,000 billion early in November. By that time the note circulation, which had been about 10 billion drachmas before the war, reached the astronomical figure of 2,500,000,000 billion.

No reports have reached here thus far as to how well the new currency is holding up in the face of the civil strife. Greece — more perhaps than other liberated countries — will need a large increase in goods to support the new currency. For the time being the sale of relief supplies is helping to finance the Government until revenues from the restored tobacco districts and from taxes are reestablished. An estimated total of £40 million is reported waiting to be transferred to Greece by emigrants now in other countries, once the currency situation becomes stabilized.

Outcome Still Uncertain

The liberated countries have shown foresight and courage in grappling promptly with their monetary problems, and credit is due them for what has thus far been accomplished. The check to the increase in bank deposits and currency in circulation in France and Belgium is in itself a very considerable accomplishment. Undoubtedly the memory of the ruinous inflations of the '20s has been fresh in many minds, and desire to avoid a repetition prompts as resolute action as possible against the present menace. Much has been learned of the techniques of monetary control since the period after World War I, and the experience will be put to the best use possible, allowing for the difficulties.

It remains to be seen whether the specific measures described above will be adequate to arrest the inflationary processes and to restore currency and credit to a sound basis. Much will depend upon the course and the length of the war, upon the strength of the government authority, and upon the determination with which people in the liberated countries will support the policies of their governments. To bring order into the tangled situation will require not only the highest degree of understanding, cooperation and submission to necessary controls, but hard work and saving, to restore production, trade and normal human relationships. The people of Europe have been through terrific physical and emotional stresses. It is expecting much to look for immediate and complete understanding and unity.

The situation illustrates the difficulties of currency stabilization after the war. It will take a long time and vigorous effort for liberated countries to get their economic systems working. It will also take time to discover when the money can be stabilized and at what level. The monetary situation necessarily reflects the general economic condition.

U. S. A.